

CITY OF SANTA BARBARA
AFFORDABLE HOUSING
POLICIES AND PROCEDURES
JULY, 2010



**AFFORDABLE HOUSING POLICIES AND PROCEDURES
OF THE CITY OF SANTA BARBARA**

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EXECUTIVE SUMMARY

Santa Barbara has actively promoted the creation and preservation of affordable housing in the City for many years. As a result, over 8 percent of the dwelling units in the City are considered to be affordable for the long-term.

Funding: The City has provided \$119.6 million in grants and loans for affordable housing. The sources of City affordable housing funding include the City's Redevelopment Agency, federal HOME funds and federal Community Development Block Grant funds. Not all affordable housing receives City financial assistance; the City's density bonus program and inclusionary housing ordinance are designed to create affordable housing without City financial assistance.

What is Meant by Affordable? Housing costs are considered to be affordable if they don't exceed a specified percentage of the household's income. Renter households should not be required to pay more than 30% of their gross monthly income on rent and utilities, and owner households should not pay more than 35% on house payments, homeowners' association dues, insurance and property taxes. Also, the unit must remain affordable to subsequent renters or owners by means of recorded long-term affordability controls.

Area Median Income (AMI): The City uses the "Area Median Income" as a basis for calculating the maximum rents and maximum sale prices permitted under the City's affordable housing programs. The U.S. Department of Housing and Urban Development (HUD) publishes AMIs for areas across the country each year; our applicable area is Santa Barbara County. The AMI for Santa Barbara County (including the City of Santa Barbara) as of May, 2010, is \$71,400. That corresponds to the median income for a household of four. AMIs are adjusted by household size.

Income Categories: The City's affordability requirements refer to the following income categories: very-low income, low income, moderate income, middle income and upper-middle income. The income ranges for the very-low and low income categories are set by HUD. All income categories are adjusted by the number of people in the household. Target Income: It would be impractical for the City to set affordable rents or sale prices based on the *actual* income of each household. Instead, affordable rents and sale prices are based on the *target income* for the income category which the unit is meant to serve. For example, low income rentals are generally targeted to households with incomes at 60% of the AMI; moderate income condos are targeted to 100% of the AMI; middle income condos are targeted to 120% of the AMI, and upper-middle income condos are targeted to 160% of the AMI.

Please note the distinction between *target incomes* and *income categories*: Income categories are used to determine who is eligible to rent or buy an affordable unit; target incomes are used to set the rents or sale prices. For example, for the purpose of setting the affordable sale price of middle income condos, the City uses a target income of 120% of AMI, but households will be eligible to buy if their income does not exceed the City's middle income limit of 160% of AMI.

Unit Size Adjustment: It would also be impractical for the City to base rents and sale prices on the actual number of people in each household. Instead, the calculations for rents and sale prices include a *unit size adjustment* for the number of bedrooms in the unit. This reflects the fact that larger units are generally occupied by larger households with a higher qualifying income range.

Affordability Requirements for Low Income Rental Units: For a two-bedroom low income rental unit (with a target income of 60%), the affordable rent would be \$999 per month. This maximum rent assumes that the landlord pays all utilities. If the tenant is required to pay some or all of the utilities, the maximum rents are reduced according to a “utility allowance” table. To assure compliance with the recorded affordability conditions, the City requires every owner of rent-restricted units to file reports with the City annually and upon each change in occupancy.

Affordability Requirements for Ownership Units: The initial maximum sale price for affordable sale units is determined according to a formula. The basic concept is simple: the price must be such that, after a 10% down payment, the monthly payments for all housing expenses will not exceed 35% of a buyer's income. Housing expenses include mortgage payments, taxes, insurance and homeowner association fees. For example, the City’s policies assume that a middle income household buying a two-bedroom unit can afford monthly housing costs of \$2,249. Plugging this into the City’s formula results in an affordable sale price of \$297,300. The price calculation is sensitive to changes in mortgage interest rates. The initial sale prices are set at the date of Planning Commission approval of the project.

Affordability Covenant: To assure long-term affordability to subsequent buyers, the City requires that an affordability covenant be recorded against each affordable ownership unit. When the owner-occupant wishes to re-sell the unit, the City approves the buyers’ eligibility and calculates the maximum resale price. In most cases this will be the price paid by the owner, increased by the percentage increase in AMI since the owner bought the unit.

Density Bonus: The City also has a density bonus program pursuant to state law and the City’s own ordinance. Through density bonus the City allows development of a greater number of units than would normally be allowed under the existing zoning. In return, some or all of the units on the site are subject to affordability restrictions. The City has approved 502 density bonus units in 82 projects.

State Density Bonus: State density bonus law requires that, for housing developments of five or more units, communities must provide a density bonus (and other benefits) if a developer proposes to provide a specified percentage of the units as affordable.

City Density Bonus: To encourage a broader range of affordable housing types and targeting than specified in state law, the City has developed its own density bonus program. For ownership developments, the City may approve a density bonus on the condition that all density bonus units are affordable *for sale to middle-income* homebuyers. For rental projects that do not meet the requirements of state law, the general requirement under the City’s program is that all density bonus units must be rented to low income households at affordable rents for at least 90 years.

Inclusionary Housing Ordinance: In 2004, the City adopted an Inclusionary Housing Ordinance that requires, in projects where there are 10 or more ownership units (excluding any density bonus units), that at least 15% of the units be sold at prices affordable to middle-income buyers. The ordinance specifies that the developer shall be entitled to a density bonus for the required inclusionary units, subject to some limitations. The ordinance applies to condominium conversions, but does not apply to rental projects. In 2009, the ordinance was amended to apply to ownership projects of 2 through 9 units as well as projects of 10 or more units. Projects of 2

through 9 units are generally required to pay a pro-rated in-lieu fee for each unit. There is no requirement that projects of this size provide an inclusionary unit, and no entitlement to a density bonus.

Minimum Unit Sizes for Affordable Units: To assure livability for the targeted household size, the City requires that affordable housing units have certain minimum floor areas. This minimum size is larger for ownership units than for rental units.

Conclusion: This Executive Summary is a brief overview of the City's affordable housing policies. For more information, please refer to the complete text.

AFFORDABLE HOUSING POLICIES AND PROCEDURES OF THE CITY OF SANTA BARBARA

PREFACE

This handbook sets forth the City's affordable housing policies and procedures as adopted by the Santa Barbara City Council; these policies and procedures are implemented by the City's discretionary bodies and staff in furtherance of the City's goal of encouraging the development and preservation of housing that is affordable to a wide range of targeted households. This handbook includes detailed descriptions of the formulas for setting maximum rents and sale prices and for determining affordability requirements for projects providing inclusionary units or receiving density bonuses. The target readership includes the Planning Commission, Planning staff, and housing developers and providers. For information about sources and availability of loans and grants for housing for low and moderate income households please contact Housing Programs staff.

I. INTRODUCTION

Santa Barbara residents enjoy a beautiful environment bordered by mountains and seashore, clean air and temperate climate, and a charming ambiance. But this jewel of a City exacts a high price from those who live here. Housing costs are among the highest in the nation.

The housing problem is one that affects the average resident of this City. Because the situation has reached a proportion where moderate and middle income residents are affected, there are immediate as well as long term effects. Low income elderly on fixed incomes, low income single parent households on public assistance, and low income persons such as the disabled with special housing needs often have no choice but to live in overcrowded and substandard situations on a budget that is so stretched that basic food and clothing necessities may be foregone. Because of the tight housing market, landlords can choose "preferable" tenants and, therefore, not rent to families with children or to those requiring modifications in the unit for handicapped accessibility. Further, the City faces a situation in which households of all income groups are leaving Santa Barbara. Young families in particular are leaving the area. Skilled workers leave for communities with higher paying jobs and more reasonable housing costs. If housing costs continue to rise beyond the means of many residents, the character of Santa Barbara which provides for a variety of social and economic groups will be seriously threatened.

The City Council has made a commitment to address the City's housing problems to the extent feasible by implementing the policies and strategies of the Housing Element of the General Plan, which is the City's housing policy document and which sets forth the City's action program for housing. One of the central goals identified in the Housing Element is the availability of affordable housing for all social and economic segments of the community.

II. THE CITY'S AFFORDABLE HOUSING ACTIVITIES

The City has implemented a comprehensive program to encourage the preservation or construction of affordable housing. Santa Barbara's housing program consists of several activities. Through most of these activities the City provides financial and/or land use incentives to a developer in exchange for a recorded agreement that some or all of the housing units will remain affordable to a certain income group (for example, "low income" or "moderate income") for a specified number of years.

As of June, 2010, there are over 5,200 affordable (or assisted) housing units and shelter/group home beds in the City, in the following categories:

- Units with Recorded Affordability Agreements
(or which are Owned by non-Profit Sponsors):

Senior Rental	1,142	
Rental – not senior-only	1,363	
Ownership	335	
Resident-owned Mobilehome Park Spaces	70	
Secondary Dwelling Units	<u>10</u>	
Subtotal of Units with Affordability Agreements:		2,920
- Section 8 Certificates and Vouchers currently in use
(1,980 less 605 included in unit counts above) 1,375
- Subtotal with Affordability Agreements plus Section 8 Vouchers: **4,295**
- Single-family Owner-occupied Rehabilitation 574
- Beds in Group Homes or Shelters 416

Total Number of Affordable and Assisted Units and Beds in the City: **5,285**

Eight percent (2,920) of the 37,000 dwelling units in the City are considered to be affordable for the long-term (*i.e.* are subject to recorded long-term affordability controls, or are owned and operated by a non-profit housing sponsor). Another 3.6% (1,375) are units where the tenants pay affordable rents under the Housing Assistance Voucher program¹ (and not included in the 8% counted above). When we add the units occupied by low-income homeowners who have received City loans and grants to repair their homes, plus the number of beds in group homes and shelters, the total number of affordable and assisted housing units (5,285) comprises 14% of the City's housing.

The City Housing Program provides assistance to affordable housing in several ways, including through providing loans and grants to developers of affordable housing, and through granting of density bonuses.

¹ operated by the Housing Authority of the City of Santa Barbara (a separate entity that works closely with the City).

A. City Financing through Grants and Loans

Between 1973 and present, the City has provided over *\$119 million* in grants and loans for affordable housing. This funding can be grouped into the following categories:

- Housing Rehabilitation Loan Program

Through its Housing Rehabilitation Loan Program (HRLP) the City provides low-interest loans for the rehabilitation of existing housing units in need of repair or seismic retrofitting. This effort assures the preservation of safe, attractive and affordable housing. Since 1976, the HRLP has loaned and granted \$33.3 million, and has rehabilitated 574 owner-occupied homes and 618 low income rental units.

- Housing Preservation (other than the HRLP)

Besides the 1,092 units improved through the City's HRLP, an additional 709 units have been preserved as affordable units through acquisition, rehabilitation, or a combination of the two. The City has provided \$13.2 million in low-interest financing for projects in this category.

- Production of New Affordable Housing

Since 1976, 2,018 new affordable housing units were built (or are currently under construction) in the City. Using funds from its Redevelopment Agency and other local, state and federal sources, the City provides low-interest loans and grants to developers of new affordable housing units for low income renters and moderate income first-time home buyers. The City has provided loans and grants totaling \$73.9 million to new affordable housing projects, including landbanking of sites for future new construction.

The following table shows the total number of affordable housing projects and units in the City by occupancy type. It also shows the total City financing for each occupancy type. Although most of the affordable units received City financing, some did not. Some affordable projects received a density bonus but no financing, and several projects developed by the Housing Authority were built using only direct federal subsidies or Housing Authority funds.

Appendix A is a complete list of all affordable and assisted housing units and beds in the City. It includes the amount of City funding per project.

**Table 1. City's Affordable Housing Projects
By Occupancy Type**

Project (Occupancy) Type	No. of Projects	No. of Units	Amount of City Financing
Senior Rental	29	1,142	\$29,330,909
Family Rental	98	1,363	61,074,001
Ownership	35	335	7,451,707
Owner-occupied Mobilehomes	2	70	225,000
Single Family Rehab	N/A	574	15,988,737
Group Housing (# of Beds)	11	416	5,582,808
Secondary Dwelling Units	10	10	0
Landbanked / predevelopment	4	N/A	3,045,000
Total through May, 2010	189	3,910	\$119,653,162

The largest source of City affordable housing financing is the City's Redevelopment Agency. As required under state redevelopment law, the City dedicates at least 20% of its "tax increment" income in its downtown redevelopment project area for affordable housing (a map of the Redevelopment Project Area is included as Appendix B). Since the City's redevelopment agency began operating in 1977, the City has provided \$66.1 million in loans and grants of redevelopment funds to affordable housing projects in the City. The City's redevelopment agency is set to expire in 2015.

The second largest source of funding for affordable housing has been federal Community Development Block Grant (CDBG) funds. Since becoming a CDBG "entitlement" jurisdiction, the City has committed \$25.3 million in CDBG funds for low income housing. Of this amount, \$16.0 million has been for building code corrections and other improvements single family homes owned by low income households. The City has committed an additional \$9.3 million in CDBG funds for the construction or rehabilitation of low income rental units.

Another major source of City affordable housing financing is the HOME program, which is a federal block grant program established in 1990. The HOME program allocates funds to jurisdictions by a formula based on various indicators of housing need. The City has committed \$12.7 million in HOME funds for low income rental projects.

Developers receiving loans and grants through the City must assure that some or all of the units will be affordable for the long term. The amount and source of funding are recommended by Housing Programs staff on a case-by-case basis.

B. Density Bonus Program

Through the City's density bonus program, the City allows development of a greater number of units than would normally be allowed under the existing zoning. As a trade-off, some or all of the units on the site are subject to rent restrictions or resale controls which provide for continued long-term affordability to low income renters, and to purchasers who are moderate income, middle income or upper-middle income.

Since the beginning of the City's density bonus program in the early 1980s, the City has approved 82 projects with density bonuses. These projects contained 1,223 affordable units, of which 502 were density bonus units.

The City's density bonus program has been affected by state legislation which was passed in 1990 and significantly amended effective January 1, 2005. Government Code § 65915 mandates that all communities provide a density bonus and other development incentives if a developer agrees to provide affordable housing as specified.

The City has adopted a density bonus ordinance (Appendix C) that provides more options to the City and developer than provided under state density bonus law. The density bonus program is implemented as part of the City's development review process. Proposed projects that include bonus units are reviewed on a case-by-case basis upon submission of project financial information, including a development budget and a proforma, to the Housing and Redevelopment Division. Please refer to Section VI below for information on affordability requirements for density bonus units.

C. Secondary Dwelling Units

The City permits a secondary dwelling unit in single family zones under tightly controlled conditions. For more information, please refer to Chapter 28.94 of the Municipal Code.

D. Condominium Conversions

Santa Barbara Municipal Code Chapter 28.88 specifies the requirements for converting existing apartments to condominiums. This ordinance has provisions relating to the affordability both of the existing apartments and the condominiums resulting from the conversion.

The ordinance provides that if any of the units in the apartment project have been rented for at least 24 of the previous 48 months at rents affordable to persons earning 90 percent of the area median income or less, then the same number of condominiums resulting from the conversion shall be sold at an affordable sale price. This price is defined as one that is affordable to middle-income persons earning 120 percent of the area median income. The determination of what is affordable is made according to policies outlined in this handbook. Copies of Santa Barbara Municipal Code 28.88 and Resolution 91-137, which further defines the affordable requirements, are included as Appendix D.

E. Inclusionary Housing Ordinance

The City has adopted an Inclusionary Housing Ordinance that requires, in projects where there are ten or more ownership units (excluding any density bonus units), that fifteen percent (15%) of the units be sold at prices affordable to middle-income buyers. This requirement applies to newly built units and ownership units created through conversion of apartments to condominiums. The ordinance specifies that the developer shall be entitled to a density bonus for the required inclusionary units, subject to some limitations. For example, a project of 20 units must provide 3 affordable units; if the land is zoned for a maximum of 20 units, the developer may be entitled to build 23 units in order to provide the required inclusionary units. In 2009, the ordinance was amended to apply to ownership projects of 2 through 9 units as well as projects of 10 or more units. Projects of 2 through 9 units are generally required to pay a pro-rated in-lieu fee for each unit. There is no requirement that projects of this size provide an inclusionary unit, and no entitlement to a density bonus. A summary of the ordinance is included in Chapter VIII below, and a copy of the ordinance is included as Appendix E.

III. THE CITY'S VIEW OF AFFORDABILITY

A. What is "Affordable"?

The term "affordable" may have a wide range of meanings to the general public, but in the City's usage it has a specific meaning. The City as well as most state and federal housing programs define affordable housing as follows: rental housing where the tenants do not pay more than thirty percent (30%) of their gross monthly income on rent and utilities, and ownership housing where the owners do not pay more than thirty-five percent (35%) on house payments, homeowners' association dues, insurance and property taxes. The unit should remain affordable to subsequent residents or owners throughout the term of the affordability controls.

B. Income Categories and Area Median Income (AMI)

The U.S. Department of Housing and Urban Development (HUD) determines the "Area Median Income" ("AMI") for areas throughout the nation, and updates the figure approximately yearly. The applicable local area is Santa Barbara County (HUD does not provide a median income specifically for the City of Santa Barbara). When used in this handbook, the term "median income" or "AMI" refers to the HUD Area Median Income for Santa Barbara County. The median income as of May 14, 2010 was \$71,400.

The City's affordability requirements refer to the following "income categories," which are usually based on various percentages of the AMI, as shown on the following table:

Table 2. Income Categories

Income Category	Percentage of Area Median Income
Very low Income	50% or below
Low Income	>50% - 80%
Moderate Income	>80% - 120%
Middle Income	>120% - 160%
Upper-middle Income	>160% - 200%

C. Income Categories in High Housing Cost Areas

HUD has changed the method of setting the maximum incomes for the very-low income and low income categories in Santa Barbara County. HUD did this in order to adjust for the high housing costs of the area. In past years, as shown in the table above, the limit for the very-low income category was 50% of the area median income (AMI) for a given household size, and the limit for the low income category was 80%.

Under the new method of calculation, HUD supplies the very-low income limits based on the incomes needed to qualify for certain subsidized housing in the area. This very-low income limit will be higher than it would be if Santa Barbara County were not a high housing cost area. And, this higher number is used as a basis for calculating other key numbers used in this handbook relating to the low and very-low income categories. In effect, HUD has created a new area median income for high housing cost areas for certain purposes. For ease of reference in the following sections of this handbook, this new number will be referred to as the “High-Cost Area Median Income” or “HCAMI”.

The High Cost Area Median Income is equal to double the HUD limit for a very-low income household of four.

$$\text{HCAMI} = \$37,000 \times 2 = \$74,000$$

This HCAMI is approximately 3.6% higher than the AMI.

HUD calculates the low income limits by taking 80% of the HCAMI. Likewise, we calculate the maximum rents for projects funded by our Redevelopment Agency on a percentage of the HCAMI. The percentages for moderate, middle and upper-middle income have not changed, and continue to be based on the AMI.

Table 3. Income Categories in High Housing Cost Areas

Income Category	Definition	Programs that Refer to this Income Category
Very low Income	In “high housing cost” areas such as Santa Barbara County, HUD provides this Very-Low Income limit.	State density bonus law, HUD’s CDBG and HOME Program financing regulations
Low Income	In “high housing cost” areas such as Santa Barbara County, this is calculated by taking 80% of the HCAMI	State density bonus law, State redevelopment law for projects receiving City redevelopment funds, HUD’s CDBG and HOME Program financing regulations, City density bonus policies for rental projects
Moderate Income	Households with incomes up to 120% of AMI (adjusted by household size). No adjustment for high housing cost areas	State density bonus law for ownership units, state redevelopment law for projects receiving City redevelopment funds
Middle Income	Households with incomes up to 160% of AMI (adjusted by household size). No adjustment for high housing cost areas	City density bonus policies for ownership projects. Middle income units do not qualify for any loan programs
Upper-middle Income	Households with incomes up to 200% of AMI (adjusted by household size). No adjustment for high housing cost areas	City density bonus policies for ownership projects. Upper-middle income units do not qualify for any loan programs

D. Adjustment for Household Size

The Area Median Income as published by HUD corresponds to the area median income *for a household of four*. As shown in the following table, the AMI varies by the number of persons in the household. This is based on the rationale that a larger household requires a higher income to maintain a minimum standard of living. HUD sets the median incomes for other household sizes by applying a multiplier to the median income of a household of four. For example, HUD sets the median income of a household of three at 90% of that of a household of four, and sets the median income of a household of five at 108% of that of a household of four.

Table 4. Median Income Adjusted by Household Size

Number of Persons:	1	2	3	4	5	6
Median Income:	\$50,000	\$57,100	\$64,250	\$71,400	\$77,100	\$82,800
% of 4 Person Income	70%	80%	90%	100%	108%	116%

Table 5, below, shows the *maximum* income that households of various sizes may have in order to be included in a certain income category (such as “low income” or “moderate income”). The City uses these income limits for setting the eligibility of renters and buyers under its affordable housing programs.

For very-low income and low income households, the income limits were provided by HUD, as discussed in section C above.

For the remaining income categories, the maximum incomes were calculated using Table 4 together with the percentage that is the upper end of the income range for each category. For example, the maximum income for a three person household to be in the moderate income category would be: $(\$64,250 \times 120\%) = \$77,100$ (rounded to the nearest \$50).

**Table 5. Maximum Incomes for Various Income Categories
Based on the AMI published in May, 2010**

Category	Range of % of Median	Number of Persons in the Household					
		1	2	3	4	5	6
Very-Low	Set by HUD	25,900	29,600	33,300	37,000	40,000	42,950
Low	Set by HUD	41,450	47,400	53,300	59,200	63,950	68,700
Moderate	Up to 120%	60,000	68,500	77,100	85,700	92,500	99,350
Middle	Up to 160%	80,000	91,350	102,800	114,250	123,350	132,500
Upper-middle	Up to 200%	100,000	114,200	128,500	142,800	154,200	165,600

Income includes not only wages or salaries of all adult household members, but also earnings on assets such as stocks and bank accounts and real property held by the household. It should be noted that the City specifies that purchasers of affordable units may not have an ownership interest in any other residential real property.

E. Income Targeting

According to Table 5, a four person household would be a low income household if its annual income from all sources is no more than \$59,200.

The City considers rent to be affordable if the household pays no more than 30% of their income for rent and utilities. However, it would be impractical for the City to set individual maximum rents based on the *actual* income of each household. Instead, the affordable rents are based upon a “target income percentage.”

This percentage will vary according to the income category that the housing is meant to serve (low income, moderate income, etc.) and the requirements of the financing program. This is discussed in more detail in the sections on “Affordability Requirements” below.

The City does not establish minimum incomes for each income category. For example, if an inclusionary housing unit is targeted to be affordable to middle income households, it is possible that a moderate-income household could qualify to purchase the unit if their down-payment is sufficient and within the limits set by the City. The City does require that the buyer pays no less than twenty eight percent (28%) and no more than forty percent (40%) of their household income for monthly housing expenses.

F. Adjustments for Number of Bedrooms (Unit Size Adjustment)

As might be expected, the City sets the maximum rents and sale prices at a higher level for units with a greater number of bedrooms. This reflects the fact that larger units will accommodate larger households, with correspondingly higher maximum allowable household incomes.

It would be impractical to set different maximum rents or sale prices based on the actual number of persons in a given household. Instead, the City makes assumptions about the average number of persons that will be occupying units with various numbers of bedrooms. For example, the City assumes that the average number of persons in a 2-bedroom unit will be 3 persons. As noted in the previous section, HUD sets the median income for a household of 3 at 90% of the median income of a household of 4. Therefore, the City multiplies the AMI by a “unit size adjustment” of 90%. This adjusts the “target” income for a 2-bedroom unit.

The City uses a unit size adjustment of 75% for a one-bedroom unit, which corresponds to the income midway between a 1-person household and a 2-person household. As shown in the following table, the other unit size adjustments have been set to arrive at reasonable rent differentials for other unit sizes. Although these unit size adjustments do not all correspond to actual household sizes, they reflect the assumption that larger units will be occupied by larger household sizes.

The state and federal government housing programs also set adjustments for various numbers of bedrooms, based on various assumed household sizes. As shown in the following tables, their assumptions about the number of persons who will occupy units differ slightly from the City’s and from each other. The one case for which the assumptions

are identical among all of the programs is for 2-bedroom units; all programs assume that 2-bedroom units will be occupied by 3-person households.

Table 6 A City Unit Size Adjustments for Middle and Upper-Middle Income Ownership Units and Density Bonus Rental Units		
# Bedrooms	Unit Size Adjustment	Assumed # in Household
SRO	0.5	NA
Studio	0.6	NA
1 Bedroom	0.75	1.5 Persons
2 Bedroom	0.9	3 Persons
3 Bedroom	1	4 Persons
4 Bedroom	1.08	5 Persons

Table 6 B State (Redevelopment) Unit Size Adjustments for Low and Very-low income Rental Units and Moderate Income Ownership Units		
# Bedrooms	Unit Size Adjustment	Assumed # in Household
Studio	0.7	1 Person
1 Bedroom	0.8	2 Persons
2 Bedroom	0.9	3 Persons
3 Bedroom	1	4 Persons
4 Bedroom	1.08	5 Persons

Table 6 C Federal HOME Program (HUD) Unit Size Adjustments		
# Bedrooms	Unit Size Adjustment	Assumed # in Household
Studio	0.7	1 Persons
1 Bedroom	0.75	1.5 Persons
2 Bedroom	0.9	3 Persons
3 Bedroom	1.04	4.5 Persons
4 Bedroom	1.16	6 Persons

IV. AFFORDABILITY REQUIREMENTS FOR RENTAL UNITS

A. Calculation of Affordable Rents

The calculation of the rent allowed by the City for an affordable rental unit depends on the last two factors discussed above: the “target income percentage” and the “unit size adjustment.”

Target income percentages and unit size adjustments for rental units are often dictated by the requirements of specific subsidy programs. For example, state redevelopment law provides that, if the City’s Redevelopment Agency housing funds are used to subsidize low income rental units, those rents must be no more than 30% of the income of a household at 60% of HCAMI. State Redevelopment law also specifies that the rent for a 2-bedroom unit should be calculated based on the income of a 3 person household. Thus, the maximum rent for a two-bedroom unit receiving below-market rate financing from the City’s Redevelopment Agency would be calculated as follows:

High Cost Area Median Income:	\$74,000 (as of May, 2010)
Target income percentage:	x 60%
Unit size adjustment for a	
2 bd unit (3 person household):	x 90%
Percentage of income for rent:	x 30%
Divided by 12 months:	/ 12
Maximum monthly rent:	= \$999

Thus, the affordable rent for a low income household in a two bedroom unit would be the fixed amount of \$999. This monthly rent would be affordable to most 3-person low income households, with those households earning between 61% and 80% of HCAMI paying less than 30% of their income for rent, and those earning between 50% and 59% paying somewhat more than 30%.

It should be noted that state redevelopment law permits higher rents for households with incomes between 60% and 80% of HCAMI; rents for those households may be set at 30% of the *actual household income*. The City may approve these higher rents in exceptional circumstances, but the City's standard requirement for low income units receiving Redevelopment Agency housing funds is that the rents be affordable at a target income of 60% of HCAMI.

The City uses several subsidy programs and incentives, and therefore uses several different target income percentages. The following table summarizes the target income percentages most commonly used by the City for affordable rental projects.

Note: In the case of the Federal Home funds (“High-HOME”), the maximum income for the residents is 60% of HCAMI, but the target rent is set under federal HOME regulations at 65% of HCAMI. The result of this HUD regulation is that low income renters of HOME-assisted units will pay more than 30% of their incomes for rent.

Table 7. Target Income Percentages Used For Rental Projects

Target Income	Maximum Income %	Target Income for 2-Bedroom Unit	Maximum Income for 2-Bedroom Unit (3 Persons)	Example of Max. Rent (2 bedrms)	Typical Applicability of this Target Income
35% of HCAMI	50% of HCAMI (very low)	\$23,300	\$33,300	\$583	Low Income Housing Tax Credits
50% of HCAMI	50% of HCAMI (very low income)	\$33,300	\$33,300	\$833	Federal HOME funds (20% of units Low-HOME) Also, State density bonus law sets this 50% target for very-low income rental units.
60% of HCAMI	80% of HCAMI (low inc.)	\$49,950	\$53,300	\$999	Redevelopment Agency (RDA). Also, State density bonus law sets this 60% target for low income rental units. Also applies to reduced parking requirements under SBMC*
65% of HCAMI	60% of HCAMI (low inc.)	\$43,300	\$39,950	\$1,083	Federal HOME funds (80% of units High-HOME)
70% of HCAMI	80% of HCAMI (low inc.)	\$46,600	\$53,300	\$1,165	Density bonus rental units under the City's density bonus program
80% of AMI	120% of AMI (moderate income)	\$53,300	\$77,100	\$1,332	State RDA law allows RDA funds to be used on units targeted to 80% of HCAMI, and counts such units as moderate income. The City has used RDA funds primarily to subsidize <i>low income</i> rentals, but has made exceptions for some moderate income rental units

*The Santa Barbara Municipal Code may allow reduced parking requirements may apply to rental projects meeting this affordability standard (SBMC 28.90.100 G.3.f.)

B. Utility Adjustments

The City's requirements for maximum rents assume that the landlord pays all utilities. If the tenant is required to pay some or all of the utilities, the maximum rents are reduced in accordance with a schedule prepared by the Housing Authority and approved by HUD. The utility schedule varies not only by number of bedrooms in the unit but also by the various utility combinations (i.e., all electric versus all electric except space heating, etc.) A chart listing the current utility adjustments for various combinations of utility payments is available from Housing Programs staff.

The following table shows the maximum rents for Redevelopment Agency funded projects, adjusted for utility allowances.

**Table 8. Maximum Low Income Rents, Adjusted for Utilities:
Target Income = 60% of AMI**

Unit Size	If Owner Pays All Utilities	If Tenant Pays Gas And Elec.	If Tenant Pays All Utilities
Studio	\$777	\$738	\$708
1 Bedroom	\$888	\$839	\$797
2 Bedroom	\$999	\$937	\$881
3 Bedroom	\$1,110	\$1,028	\$943
4 Bedroom	\$1,199	\$1,104	\$1,012

C. Section 8 Housing Choice Voucher Program

In some cases the City has permitted owners of rent-restricted units to receive substantially higher rents than those listed above, provided the owner rents to holders of "Section 8 vouchers." Through this program, administered by the Housing Authority of the City of Santa Barbara, the tenant pays 30% of their income for rent and utilities. Federal funds are paid to the landlord to make up the difference between this tenant share and the "Fair Market Rent" (FMR). HUD periodically establishes FMR's for the County of Santa Barbara based on a survey of rents. North-County rents are much lower than rents on the South Coast. Thus, the FMR's calculated by HUD for Santa Barbara County are usually far below actual market rents in the City. In response to this disparity, at the request of the City Housing Authority, HUD has approved an "exception rent" for the City that allows FMR's to be increased substantially. With this increase, the FMR's more closely approximate market rents in the City. The Housing Authority inspects each apartment participating in the Section 8 program to verify that the rent charged does not exceed its market value.

By way of example, the latest FMR, as of May, 2010, for a two-bedroom unit is \$1,259. This is still less than the median advertised rent for a 2-bedroom apartment in the City, which was \$1,700 in April, 2010.

Currently many private landlords are participating in this program and accepting tenants with Section 8 vouchers. However, the number of participating landlords has varied significantly over time. An important factor affecting landlord participation is how the FMR's compare to the rents that the landlord could receive on the open market. HUD has not always allowed exception rents, and there is no guarantee that they will continue to do so. Another factor affecting landlord participation is the demand for rental units. In a tight rental market, landlords have many more qualified applicants than units, and they have no incentive to accept low income tenants with vouchers.

In times of low landlord participation in the Section 8 voucher program, many low income households who have qualified for vouchers cannot find a landlord to accept them, and this important federal housing subsidy goes under-utilized in Santa Barbara. At such times, it is consistent with the City's affordable housing goals for the City to encourage owner participation by providing subsidies to developers who agree to accept Section 8 vouchers over the long term. In times of high voluntary participation by landlords, it is not necessary for the City to encourage participation. In such times, the public benefit of units restricted to a target income (such as 60% of AMI) will be significantly greater than the public benefit of a unit restricted to Section 8 vouchers. The City must consider this variable public benefit of Section 8 subsidies in determining whether to further subsidize projects which rely on the Section 8 program to achieve affordability.

Also, the City must consider the impact of a possible future reduction of the number of available Section 8 vouchers. While the Section 8 program is a keystone of the current federal housing programs, it is funded annually by the federal government, and there is no guarantee that the subsidies will continue for the full 60 year term of the City's affordability requirements, or even for 5 or 10 years. In the event that the developer of a rent-restricted project cannot find a tenant with a Section 8 voucher, the City's policy is generally that the unit must be rented at rents affordable to 60% of AMI. In the case of a two bedroom unit, this would reduce the rent from the FMR of \$1,259 to \$999 (including utilities). If a significant percentage of the units in a project were to be subject to such reductions, the project could be in jeopardy of default on its loans, or the City's affordability requirements, or both.

In order to limit the number of units for which a Section 8 subsidy is used by the developer to meet the City's affordability requirements, and to help assure the long-term affordability of such units, the City will consider allowing Section 8 FMR's as qualifying rents on a case-by-case basis, with preference given to projects that meet all of the following requirements:

- The project is developed and 100% owned by an affordable housing developer with a substantial track record of affordable housing development and operation in Santa Barbara.
- No more Section 8 units are proposed in the project than are needed to make the project financially feasible.
- All of the Section 8 units have received a long-term "project-based" Section 8 allocation through the City or County Housing Authority.

- The developer must demonstrate that, in the event that the rents on the Section 8 units revert to the specified percentage of AMI, the project will be able to cover any resulting operating shortfall through one or more of the following means:
 - The project or owner has set aside adequate reserves to cover such operating shortfall for a reasonable period of time
 - The project has borrowed funds from the City which it is repaying on a “residual receipt” basis (i.e. repaying the loan solely with remaining cash-flow after all expenses), and the shortfall can be covered by suspending the repayments to the City
 - Other means which are determined by the Community Development Director to reasonably assure that the project will be able to cover its expenses and maintain the required rents in the event that eligible Section 8 voucher holders are no longer available as tenants.

D. Units Receiving Zoning Modifications

Owners often wish to make improvements to their residential properties that are not in strict compliance with the City’s zoning ordinance. Many properties were legally developed decades ago when the zoning requirements were less stringent. For example, there are many lots that were legally developed with more units than current zoning would allow. Owners of these “legal non-conforming” properties may not add square footage or intensify the use unless they receive a zoning modification. The City’s Staff Hearing Officer, and in some cases the Planning Commission, must determine on a case-by-case basis whether, and under what conditions, such zoning modification should be approved.

On lots where the number of units is legal non-conforming, an owner wishing to add a room onto an existing unit may request a “lot area modification.” Such modifications are akin to a density bonus, and are usually only granted by the City in exchange for recorded affordability conditions on one or more of the units. However, the City’s standard low-income rental requirement (90 year term targeted to 60% of AMI) is usually a disproportionate imposition on the applicant compared to the benefit conferred by the modification. The City’s Community Development Director has the authority to reduce or waive the affordability requirements on a case-by-case basis for zoning modifications on existing units. For example, in the case of an applicant wishing to add a bathroom to a legal non-conforming duplex that has slightly under the required lot area, a Section 8 rental requirement may be approved, as well as a term substantially shorter than 90 years. If the modification is for the purpose of legalizing an illegal dwelling unit that is the subject of an enforcement action, the affordability requirements will be much more stringent.

E. Documents and Reporting Requirements

Every owner of rent-restricted units is required to file reports with the City annually and upon each change in occupancy. These reports will contain information and copies of documents which the City requires to assure compliance with the affordability conditions. A document titled "Requirements for Low Income Rental Units" explains the requirements in more detail, and should be read carefully by any owner considering the development of

rent-restricted units. This or a similar document will be attached to the conditions of approval for the project. Language setting forth these requirements will be included in an affordability control covenant to be recorded against the real property.

V. AFFORDABILITY REQUIREMENTS FOR OWNERSHIP UNITS

The initial maximum sale price for affordable sale units is determined according to a formula. Although the definitions and narrative of the formula are lengthy, the basic concept is simple: the unit must be affordable to the new buyer; therefore, the price must be such that after a ten percent (10%) down payment, the total monthly payments for the loan, taxes, insurance and homeowner association fees will not exceed thirty-five percent (35%) of a hypothetical “target” buyer's income. A housing cost-to-income ratio of 30% is used for low and very-low income units that are funded with City Redevelopment Agency funds.

A. Mortgage Interest Rate

The sale price calculation is very sensitive to changes in mortgage interest. The higher the interest rate, the lower the mortgage a given monthly loan payment will support. If the initial sale price is calculated at a time that interest rates are unusually low, subsequent buyers will have difficulty affording the unit if interest rates have increased substantially in the interim. To further the goal of long term affordability, in order to smooth out interest-rate fluctuations, the City will use the following procedure for setting the interest rate that is used for the calculation of initial sale prices of affordable units:

At least once per year, concurrently with the annual publication of the Area Median Income by HUD and upon any update of these Affordable Housing Policies and Procedures, the City will set the interest rate to be used in its sale price calculations as the higher of the following two rates:

- (a) the average rate charged by local institutional lenders on a zero point 30-year fixed rate mortgage
- (b) the average ten-year treasury constant maturity rate over the most recent 24 months, plus 200 basis points (2.0%), or

Example: the average ten year treasury yield for May, 2008 through April, 2010, calculated from monthly data published on the U.S. Treasury Department web site, was 3.475%. Adding the 200 basis points and rounding results in an interest rate of 5.5%.

B. Private Mortgage Insurance

The above calculation for the mortgage interest rate assumes a 20% down payment. However, most buyers of affordable units cannot afford a 20% down payment. In recognition of this, the City assumes a 10% down payment in its affordable price calculations. However, if a borrower is putting less than 20% as a down payment, conventional mortgage lenders require the borrower to either obtain private mortgage insurance (PMI) or obtain a second deed of trust loan (at a higher interest rate) for the amount of financing above 80% of value. Either of these options increases the costs to the borrower. In the past, these extra costs have not been included in the City's affordable price

calculations. Staff estimates that these added costs are equivalent to increasing the mortgage interest rate between one-half and three-quarters of one percent (0.5 to 0.75%). Staff will recommend that City Council consider whether to increase the mortgage interest rate used in the sale price calculation 0.5% to account for the extra costs of PMI or secondary financing. The effect of this change will be to lower the affordable sale price somewhat, thus making the units more affordable to the majority of new buyers who have a down-payment of less than 20%.

C. Homeowner Association Fees

The sale price calculation is also sensitive to changes in homeowner association (HOA) fees. The higher the HOA fees, the lower amount of the buyers' income that is available for mortgage payments. City staff is aware of many buyers of affordable units whose HOA fees have increased substantially after they purchased their unit. This has the effect of making their unit less affordable to them and to subsequent buyers. To assure that the HOA fee used in the City's initial sale price calculations is adequate, Housing Programs staff will survey several established homeowners' associations and arrive at an average. For the period starting with the May 2010 publication of the HUD AMI, staff has established an average HOA expense of \$420 per month.

D. Price Calculations

Please refer to Appendix F for a sample calculation of the maximum sale prices for middle income units, targeted to 120% of the AMI. This calculation incorporates the mortgage interest rate of 5.50%, and the monthly HOA expense of \$420.

Selected target incomes and prices for the various income ranges used for ownership units are shown in the following two tables.

(continued on next page)

Table 9A. Target Income Percentages Used For Ownership Projects

Target Income %	Maximum Income %	Down Payment Assumed in Price Calculation	Example of Max. Price (2 bedrms)	Type of Subsidy Typical for this Target Income
70% (low)	80% (low)	5%	\$89,500	Low incomes are seldom targeted for affordable sale housing because of the very high subsidies needed.
110% (moderate)	120% (moderate)	5%	\$235,800	Redevelopment Agency (RDA)
120% (middle)	160% (middle)	10%	\$297,300	No subsidy sources are available for above-moderate incomes – but density bonuses are allowed for middle-income units
160% (upper-middle)	200% (upper-middle)	10%	\$419,200	

**Table 9B. Maximum Sale Prices For Affordable Ownership Units
By Unit Size and Income Category**

	Target Income	Studio	1 BD	2 BD	3 BD
Moderate Income	100%	\$173,200	\$205,600	\$237,500	\$267,100
Middle Income	120%	\$177,100	\$238,000	\$299,000	\$339,500
Upper Middle Income	160%	\$258,300	\$339,500	\$420,900	\$474,900

VI. DENSITY BONUS UNITS UNDER STATE LAW

Changes to California state density bonus law became effective on January 1, 2005. The revised law requires cities and counties to provide *all* of the following incentives to applicants who include specified affordable housing in their projects:

- *density bonuses* of between 5 and 35 percent, depending on the amount and type of affordable housing provided (in other words, the city must approve projects with more units than allowed by zoning); and
- *reduced parking standards* that apply to the entire project, not just the affordable units (for example, uncovered parking and tandem parking must be approved); and
- *mandatory "concessions or incentives"* – the applicant may select between 1 and 3 exceptions from the normal development standards of the city (depending on the amount and type of affordable housing provided); and
- *additional "waivers and modifications"* of development standards if the applicant shows that they are needed to make the housing economically feasible.

The complete text of the law (Government Code sections 65915-65918) is available on-line at www.leginfo.ca.gov/calaw.html

A. Affordable Housing Requirements

Under state density bonus law, housing developments that create at least 5 dwelling units (or 5 unimproved lots) are eligible for a density bonus if a specified percentage of units are provided at affordable rents or sale prices to very low income, low income, or moderate income households.

B. Density Bonuses Available

The law requires a greater density bonus for very-low and low income housing and a lesser density bonus for moderate-income ownership housing than did the previous law.

- Housing developments are eligible for a **20% density bonus** if:
 - **5%** of units are affordable to **very-low** income households; or
 - **10%** of units are affordable to **low** income households.
- Housing developments qualify for a **5% density bonus** if :
 - **10%** of the units are ownership units affordable to **moderate** income households.

In addition, projects that provide more than the minimum percentage of affordable units are entitled to a greater percentage of density bonus (up to a maximum density bonus of 35%). The following table is a summary of the requirements for each income category:

Table 10. Density Bonus under State Law

Income Category	Minimum % of Units that must be Affordable	Density Bonus Required by State Law	Additional Density Bonus for each 1% increase in Affordable Units
Very-Low	5%	20%	2.5%
Low	10%	20%	1.5%
Moderate	10%	5%	1%

The result is that applicants who provide very-low and low income affordable units are generally entitled to a greater number of density bonus units than the number of affordable units they provide. For example, on a site zoned for 10 units, the applicant who provides 1 unit for very-low income households (10% of the base density) is entitled to 4 density bonus units.

C. Reduced Parking Standards

If a project qualifies for a density bonus because it provides affordable housing, the city must grant the applicant's request to reduce the required parking for the entire project—including the market-rate units—to no more than the following:

- zero to one bedroom – one on-site parking space
- two to three bedrooms – two on-site parking spaces
- four or more bedrooms – two and one-half on-site parking spaces.

These numbers *include guest parking and handicapped parking*. The spaces *may be in tandem or uncovered*. They cannot be on-street. If the project provides the required affordable housing, the parking standards may be requested even if no density bonus is requested.

D. Other Modifications to Development Standards

In addition to the reduced parking standards, the state law gives applicants the right to request modifications in local development standards such as zoning, subdivision controls, and design review requirements. The law mandates the approval of such incentives and concessions in specified circumstances.

E. Santa Barbara's State Density Bonus Implementing Ordinance

The state density bonus law requires that all cities adopt an ordinance specifying how they will comply with the legislation. Santa Barbara's density bonus ordinance (included as Appendix C) has not yet been updated to reflect the 2005 changes. However, the City has complied with the new state requirements in the few applications we have received under the revised law. A revised ordinance will be forthcoming. Staff recommends that the City's implementing ordinance contain a requirement that, in determining the required number of affordable units, any fractional number of required units be rounded up to the next whole number of units. Also, staff recommends that the affordable units be required to provide at least the same average number of bedrooms as do the density bonus units.

VII. THE CITY'S DENSITY BONUS PROGRAM

The state law does not address several issues that the City has faced. What affordability requirements would be appropriate if the developer requests a density bonus greater than 35%? What about projects of four or fewer units, where state density bonus law does not apply?

To address these and other issues, and to encourage a broader range of affordable housing types and targeting than specified in state law, the City has developed its own density bonus program. This program is meant to compliment and expand upon state density bonus law. The procedural elements of the City's density bonus program are outlined in §28.87.400 of the Municipal Code (attached as Appendix C). This ordinance specifies the procedures to be followed by developers who request a density bonus, both for projects that meet the criteria set forth in state density bonus law and for projects that do not. The latter projects are to be reviewed by the City "for consistency with the criteria of the City's density bonus program, described in the City of Santa Barbara Affordable Housing Policies and Procedures Manual." The referenced description of the City's density bonus program follows in the sections that follow.

Under the City's program, for projects in which the units developed within the base density are to be ownership units, the density bonus units under the City's program must generally be ownership units as well. The Community Development Director may approve exceptions to this requirement for projects in which each of the density bonus units is either rented for at least 90 years according to the City's requirements for density bonus rental units (explained below), or sold according to the specified requirements.

A. City Density Bonus Requirements for Ownership Units Within the First 25% Density Bonus

Density bonus is sometimes expressed as a percentage. For example, if the zoning and size of a property would allow the development of 20 units but the developer is requesting approval to build 24 units, those extra 4 units would be considered to be a 20% density bonus, because the 4 density bonus units requested would be 20% of the 20 units otherwise allowed under the zoning (the "base density"). Likewise, a project zoned for 9 units that is approved for 12 would receive a 33% density bonus.

For units within the first 25% density bonus, all density bonus units must be sold at prices affordable to middle income households (or upper-middle income if the development is single family houses each on its own lot) at prices which, *on average*, are targeted to the following incomes:

- (a) for condominiums, 120% of AMI
- (b) for duplexes, 130% of AMI. Note: for especially large and desirable condominiums that approximate the livability and features that buyers might expect from duplex units, the Community Development Director may approve a target income of 130% of AMI.
- (c) for single family homes on separate lots, 160% of AMI

The prices for condos and duplexes are targeted to be affordable to middle-income first time homebuyers (that is, with incomes between 120% and 160% of AMI). Buyers with incomes below 120% of AMI are also eligible to buy these units, provided they can qualify for the mortgage loan. Buyers with incomes above 160% of AMI, adjusted for their household size, would not be eligible. The prices for single-family homes on separate lots are targeted to be affordable to upper-middle income households (160% to 200% of AMI). Buyers with incomes below 160% might be eligible, but those above 200% would not.

There is no requirement regarding the number of bedrooms in the density bonus units, unless the density bonus units are being counted to satisfy the City's inclusionary housing requirements.

The target incomes listed above are for ownership projects without City subsidies, and are higher than those allowed by any of the subsidy sources available through the City. Projects receiving City subsidies will be required to target the density bonus units to moderate income or below.

B. City Density Bonus Requirements for Ownership Units Above the First 25% Density Bonus

In order to provide incentive to developers to provide additional affordable units under the City's program, higher income targeting and pricing will be allowed for those density bonus units that are receiving greater than a 25% density bonus in the project. For example, on a site zoned for 16 units where 6 density bonus units are approved (for a total of 22 units), the first 4 density bonus units would be considered within the first 25% density bonus. The last 2 density bonus would be above the first 25% density bonus. Such units may be sold to upper-middle income (rather than middle income) homebuyers at prices which, on average, are targeted to the following incomes:

- (a) for condominiums, 160% of AMI Note: affordable condominium units at this price point are expected to be larger and more desirable than those within the first 25% that are targeted to 120%.
- (b) for duplexes, 170% of AMI
- (c) for single family homes, 180% of AMI

C. Market Rate Density Bonus Units

In some cases the City has permitted a density bonus unit to be sold at market rate, because the remaining affordable units were sold at lower prices than otherwise required. The rationale for this policy was based on a "below-market benefit test" based on the difference between the total prices of the affordable units and the total prices of the market rate units. However, this approach has proven to be difficult to apply.

D. City Density Bonus for Rental Projects

Rental projects requesting density bonus that do not meet the requirements of state law must meet the following requirements:

For units within the first 25% density bonus – the density bonus units must be rented for at least ninety (90) years to low income households at rents targeted, on average, to 70% of AMI or below.

For units above the first 25% density bonus – the density bonus units must be rented for at least ninety (90) years to low income households at rents targeted, on average, to 80% of AMI or below.

Note: these target rents are higher than those allowed by most subsidy sources available from the City. Projects receiving City subsidies will generally be required to target the affordable units to 60% of AMI or below. Redevelopment Agency funds may potentially be used to subsidize projects with moderate income rents, but the City has not often subsidized projects with rents above the state-defined Redevelopment Agency low income targets of 60% of AMI.

VIII. INCLUSIONARY HOUSING ORDINANCE

In 2004 the City Council adopted the City's Inclusionary Housing Ordinance, which requires that new residential developments of ten or more ownership units must sell at least 15% of the units at prices that are affordable to middle income homebuyers. In May 2009, the Ordinance was amended to apply an inclusionary fee requirement to ownership projects of fewer than ten units. Condominium conversion projects are subject to the Ordinance, but apartment projects (where the units may not be sold separately) are not.

Among the stated purposes of the ordinance are to implement the policy of the City's Housing Element which encourages development of housing for first time home buyers, including moderate and middle income households, protection of the economic diversity of the City's housing stock, and reduction of commuting and related air quality impacts.

The following paragraphs summarize the main requirements of the Inclusionary Housing Ordinance, but the reader is encouraged to refer to the complete text of the Ordinance for more complete information. The Ordinance is at Chapter 28.43 of the City's Municipal Code, and is included herein as Appendix E.

A. Projects of Ten or More Ownership Units or Lots

For all residential subdivision developments of 10 or more units, the developer must either designate at least 15% of the total units as inclusionary units for owner-occupancy by middle-income households, or must pay an in-lieu fee. As an incentive to provide the units on-site, the developer is entitled to a density bonus for the number of inclusionary units to be provided on-site. The City also may (but is not required to) provide zoning modifications (such as reduced setback requirements, for example) to facilitate the increased density. Other Ordinance requirements:

- In determining the number of inclusionary units required, any decimal fraction of less than 0.5 shall be rounded down, and any decimal fraction of 0.5 or more shall be rounded up.
- The Ordinance also applies to "dry lot" subdivisions that would create lots for the eventual development of 10 or more units, and requires the payment of an in-lieu fee.
- Prices of the inclusionary units are generally required to be affordable to middle income households, using a target income of 120% of Area Median Income (AMI). Currently the maximum sale prices for inclusionary units are:
 - 1 bedroom, \$223,300
 - 2 bedroom, \$280,800
 - 3 bedroom, \$319,100
- For inclusionary units built as duplexes, or especially large and luxurious condominiums that approximate the livability and features that buyers might expect from duplex units, the Community Development Director may approve a target income of 130% of AMI. For example, a 2 bedroom unit at this price point could be sold for a maximum of \$309,500.

- Inclusionary units built as detached single-family homes, each on its own separate lot, shall be sold at prices affordable to upper-middle income households, using a target income of 160% of AMI. For example, a 2 bedroom unit at this price point could be sold for a maximum of \$395,700.
- Inclusionary units must be disbursed evenly throughout the development and must be comparable in construction quality and exterior design to the market-rate units, but may be smaller in size and have different interior finishes and features.
- The average number of bedrooms in the inclusionary units must at least equal that of the market-rate units. The minimum unit sizes and number of baths are also specified.
- All inclusionary units must be completed and occupied concurrently with or prior to the market-rate units. In phased projects, inclusionary units must be included proportionally in each phase.
- Affordability control documents must be approved by the City and recorded prior to the issuance of the grading permit or building permit, whichever comes first.
- For every residential development to which the Ordinance applies, an Inclusionary Housing Plan must be submitted as part of the application. The Ordinance specifies the required elements which must be included in such Plan.
- Projects that voluntarily provide at least 30% of their units at prices affordable to upper-middle income households are exempt from the Ordinance. Unlike inclusionary units required under this ordinance, however, there is no entitlement to a density bonus for these upper-middle income units. As an example of maximum sale prices, the current maximum sale price for a 2 bedroom upper-middle income unit is \$395,700.

In-Lieu Fee and Alternate Methods of Compliance for Projects of 10 or More Units

The requirements of the Ordinance may also be satisfied by paying an in-lieu fee. Currently the formula for calculating the in-lieu fee results in a fee of \$310,000 per required inclusionary unit. The in-lieu fee is calculated as follows: The median sale price of 2-bedroom condominiums in the City during the most recent 4 quarters (\$470,000) less 15% to arrive at the “estimated production cost of a 2-bedroom unit” (\$399,500) less the affordable sale price of a 2-bedroom low-income unit under the City’s policies (\$89,500), which equals \$310,000. The in-lieu fee represents the difference between the cost of building a new unit and the price that a low-income affordable unit could be sold for.

The in-lieu fee is re-calculated annually when HUD publishes new Area Median Income figures. The current in-lieu fee amount will be in effect until HUD publishes the 2011 AMI figures. The in-lieu fee for a project is the fee that is in effect as of the date of final Planning Commission approval of the project. The in-lieu fee must be paid prior to the issuance of building permits (except for projects of 1 through 4 units, where payment of the fee may be delayed until just prior to issuance of the Certificate of Occupancy).

To encourage projects with smaller-than-average units, the in-lieu fee is reduced between for projects in which the average size of market-rate units is smaller than 1,700 square feet, per the following table:

Average Unit Size of Market-Rate Units in Net Square Feet	Percentage Reduction in In-Lieu Fee	Reduced In-Lieu Fee
1,400 to 1,699	15%	\$263,500
1,100 to 1,399	20%	\$248,000
800 to 1,099	25%	\$232,500
Below 800	30%	\$217,000

The Planning Commission may accept alternate methods of compliance that are proposed by the applicant, including off-site construction of the inclusionary units, dedication of land for affordable housing purposes, or a combination of approaches. For example, the requirements may be met through a combination of providing inclusionary units on-site and paying an in-lieu fee. A 10-unit project would have an inclusionary requirement of 1.5 units. This could be met by building 2 affordable inclusionary units on-site, or by paying an in-lieu fee for 1.5 units. Unless the average size of the market rate units is below 1,700 square feet, the in-lieu fee for 1.5 units would be $(1.5 \times \$310,000 =) \$465,000$. Or, the requirements could be met by building one affordable inclusionary unit and paying one-half of the in-lieu fee for one unit (\$155,000).

B. Projects of Two through Nine Ownership Units or Lots

All residential subdivision projects of 2 through 9 units or lots (including condominium conversion projects) must pay an inclusionary housing fee. Unlike the inclusionary requirements for projects of 10 or more units, there is no requirement that these smaller projects provide an affordable unit, and there is no entitlement to a density bonus if an affordable unit is included by choice as an alternative to paying the inclusionary housing fee.

The pro-rated inclusionary housing fee for smaller projects is currently \$15,500 per unit or lot. This is equal to 5% of the \$310,000 in-lieu fee. This fee amount will be in effect until HUD publishes the Area Median Income numbers for 2011. For projects involving the construction of 5 or more units, the fee must be paid prior to the issuance of building permits. To reduce the financial impact on projects of 4 units or less, the due date for payment of the in-lieu fee is postponed until just prior to issuance of the Certificate of Occupancy.

To encourage projects with smaller-than-average units, the pro-rated inclusionary housing fee is reduced for projects in which the average size of market-rate units are smaller than 1,700 square feet, per the following table:

Average Unit Size of Market-Rate Units in Net Square Feet	Percentage Reduction in In-Lieu Fee	Reduced In-Lieu Fee	Pro-Rated Inclusionary Fee
1,400 to 1,699	15%	\$263,500	\$13,200
1,100 to 1,399	20%	\$248,000	\$12,400
800 to 1,099	25%	\$232,500	\$11,600
Below 800	30%	\$217,000	\$10,900

Partial Exemption: For projects that involve the construction of up to 4 new units, 1 unit is exempt from the inclusionary fee requirement. Projects that will provide up to 4 new

units and include one existing unit that will remain on site are eligible for this partial exemption. Projects that include conversion of 2 or more units to condominiums, or that include the construction of 5 or more new units, are not eligible for this exemption.

C. Examples and Tables

Condo Conversion: Application to convert an 8-unit apartment building into 8 condominium units: An inclusionary fee of \$124,000 (8 x \$15,500) must be paid prior to the issuance of a building permit. However, if the average size of the condo units is under 1,700 square feet, the fee will be reduced. For example, for an average unit size of 1,000 square feet the fee would be \$92,800 (8 x \$11,600).

“Dry-Lot Sudivision”: Application to subdivide a parcel into 9 residential lots for sale to future owner-builders: An inclusionary housing fee of \$139,500 (9 x \$15,500) must be paid prior to recordation of the Final Subdivision Map. For a subdivision of 10 lots, a 15% inclusionary requirement will apply so the in-lieu fee would be \$465,000 (1.5 x \$310,000).

Condo Conversion plus New Construction: Application to convert a duplex apartment into 2 residential condominiums and to build 2 additional units on the lot: An inclusionary housing fee of \$62,000 (4 x \$15,500) must be paid. The fee for the 2 condominium conversion units must be paid prior to the recordation of the final subdivision map. Because the project is no more than 4 units, payment of the fee for the remaining 2 units may be delayed until just prior to the issuance of the Certificate of Occupancy. This project is not subject to the partial (1-unit) exemption described above because this involves a condominium conversion. Projects where the market rate units average under 1,700 square feet may get a reduction in the in-lieu fee.

Projects of up to 4 New Units: Application to demolish a duplex apartment building and build 4 new condominium units on the lot: This is subject to the partial exemption described above because it involves the construction of no more than 4 new units. An inclusionary housing fee of \$46,500 (3 x \$15,500) must be paid, but payment may be deferred to just prior to the Certificate of Occupancy because the project is 4 or fewer units. Projects where all units average under 1,700 square feet may get a reduction in this fee.

Subdivision with 2 Existing Houses: Application to do a lot split of a large lot with 2 existing houses to create 4 lots, with the 2 existing houses to be each on their own lots and 2 new houses to be built each on their own lots: This is subject to the partial exemption described above because this is not a condominium conversion and involves the addition of no more than 4 new units. An inclusionary housing fee of \$46,500 (3 x \$15,500) must be paid prior to the Certificate of Occupancy, but payment may be deferred to just prior to the Certificate of Occupancy because the project is 4 or fewer units. Projects where all units average under 1,700 square feet may get a reduction in this fee.

TABLES: The following 3 tables provide additional information and examples for projects of 2 through 9 units, depending on factors such as the number of existing units on the site and whether any units are being converted to condominiums.

Use Table 1 if there are no existing units on the site, or if all existing units will be demolished prior to the construction of the new project

Use Table 2 if there is one (and only one) existing unit that will remain on the site

Use Table 3 if there are 2 or more existing units to remain on the site that will be converted to condominiums

Inclusionary Table 1 If There Are No Existing Units on the Site, or If All Units will be Removed (the Project is all new construction)		
Number of New Units to be Built	Number of Units For Which a 5% In-Lieu Fee Requirement Applies	Total Pro-Rated In-Lieu Fee Required*
1	The Inclusionary Ordinance does not apply to 1-unit projects because there is no subdivision, condo map or new lot creation	NA
2	1 - (1 unit is exempt**)	\$15,500
3	2 - (1 unit is exempt**)	\$31,000
4	3 - (1 unit is exempt**)	\$46,500
5	5	\$77,500
6	6	\$93,000
7	7	\$108,500
8	8	\$124,000
9	9	\$139,500
10 or More	15% Inclusionary Requirement Applies	NA
*Pro-rated in-lieu fee = 5% of the full in-lieu fee (\$310,000 x 5% = \$15,500). However, the in-lieu fee will be reduced if the average size of the market-rate units is below 1,700 sq. ft.		
**In projects that propose to build up to 4 new units, one unit is exempt from payment of the pro-rated in-lieu fee; however, this exemption does not apply to projects that involve the conversion of existing units to condominiums. (see SBMC 28.43.030.A.2).		

Inclusionary Table 2 If There is One (and only one) Existing Unit to be Retained on the Site		
Number of New Units to be Built	Number of Units For Which a 5% In-Lieu Fee Requirement Applies	Total Pro-Rated In-Lieu Fee Required*
1	1 – (1 unit is exempt**)	\$15,500
2	2 - (1 unit is exempt **)	\$31,000
3	3 - (1 unit is exempt**)	\$46,500
4	4 - (1 unit is exempt**)	\$72,000
5	6	\$93,000
6	7	\$108,500
7	8	\$124,000
8	9	\$139,500
9 or more	15% Inclusionary Requirement Applies	NA
*Pro-rated in-lieu fee = 5% of the full in-lieu fee (\$310,000 x 5% = \$15,500). However, the in-lieu fee will be reduced if the average size of the market-rate units is below 1,700 sq. ft.		
**In projects that propose to build up to 4 new units, one unit is exempt from payment of the pro-rated in-lieu fee (see SBMC 28.43.030.A.2)		

Inclusionary Table 3 If the Project Involves a Condominium Conversion (Whether or Not New Units are Also Being Constructed)			
If there are 2 or more existing units on the site that will be converted to condominiums, add the number of existing units to the number of new units (if any).			
Examples:			
What is the Number of Existing Units?	What is the Number of New Units to be Built?	Number of Units For Which a 5% In-Lieu Fee Requirement Applies	Total Pro-Rated In-Lieu Fee Required*
2	1**	3	\$46,500
2	2**	4	\$72,000
3	4**	7	\$108,500
4	5	9	\$139,500
5	5	10 (so 15% inclusionary requirement applies)	NA
*Pro-rated in-lieu fee = 5% of the full in-lieu fee (\$310,000 x 5% = \$15,500). However, the in-lieu fee will be reduced if the average size of the market-rate units is below 1,700 sq. ft.			
**There is no 1-unit exemption when a condominium conversion is part of the project			

IX. DEVELOPMENT REVIEW OF AFFORDABLE PROJECTS

A. Minimum Unit Sizes for Affordable Units

The maximum rents and sale prices for affordable units are adjusted according to the number of bedrooms; implicit in this adjustment is the assumption that larger units will house larger households. To assure that affordable units are large enough for the number of people for which they are meant, these policies set minimum sizes.

Exceptions to the minimum sizes in the following table may be made by the City's Community Development Director if he or she determines that either (1) the smaller sizes of the units are appropriate and necessary for the feasibility of the development in light of site constraints and targeted residency, or (2) the average size of the market rate units in the project is smaller than the minimum unit size, or (3) the smaller sizes of the units are compensated by non-standard design features that make the smaller units equivalent in function and comfort to a unit without these design features but which meets the minimum size requirement. Non-standard design features might include larger private outdoor living space, higher ceilings, more generous fenestration, attractive and spacious common area for the residents, or a combination of these or other features.

The minimum unit sizes in net square feet of floor area are as follows:

Table 11. Minimum Sizes for Affordable Units

	Low-Income Rental Units	Moderate Income Ownership Units
Studio:	400 sq. ft.	450 sq. ft.
1 Bedroom:	540 sq. ft.	600 sq. ft.
2 Bedroom:	765 sq. ft.	850 sq. ft.
3 Bedroom:	990 sq. ft.	1,100 sq. ft.
4 Bedroom:	1,150 sq. ft.	1,300 sq. ft.

Absent a waiver from the Community Development Director, two bedroom affordable units shall have at least one and one-half bathrooms, and three and four bedroom affordable units shall have at least two bathrooms. However, the required number of bathrooms shall not be greater than the number of bathrooms in the market-rate Units.

These minimum sizes were developed for low income rental projects and condominiums targeted to moderate income households. Projects targeted to higher income groups (such as moderate income rentals and middle income ownership units) will be allowed higher rents/sale prices, and will be expected to provide larger minimum unit sizes. Likewise, duplexes and single family homes may be sold at substantially higher affordable prices than attached condos and will be expected to provide more living space than these minimum sizes. Similarly, the City may approve higher prices for condos classified as especially large or desirable, and in such cases the City will

require more living space. In these cases, the proposed sizes of the affordable units will be reviewed and approved by the Community Development Director on a case-by-case basis.

B. Application and Permitting Process for Affordable Projects

Projects with affordable dwelling units go through the same development review process as other residential developments, but are subject to a few additional steps. The developer will have contact with the City's Housing Programs staff, who implement the City's affordable housing programs and assure compliance with the requirements of those programs.

1. Housing Programs staff will prepare a draft of the implementing document, such as a recorded covenant; the developer will be advised obtain written approval of the resale control structure from all lenders. Prior to issuance of building permits, the developer must execute and record the affordability control covenant.
2. Prior to the issuance of a Certificate of Occupancy and prior to the initiation of marketing of the affordable units, the developer must submit a marketing plan to be reviewed and approved by Housing Programs staff. Such plan must describe the proposed advertising methods and staff training the developer plans in order to comply with federal, state and local fair housing laws. The plan must also propose a process for the application by and selection of eligible purchasers and identify any preferences to be given. Prospective buyers must be screened to meet the applicable City requirements. The City shall conduct a lottery to determine a sequential ranking of applicants. The applicant first drawn has the first opportunity to be fully qualified to purchase and shall get first selection of a unit. The process continues until there is a fully qualified purchaser for each available affordable unit.
3. Housing Programs staff must approve the eligibility of the initial renters or purchasers, and the initial rent levels or sales prices and financing. Housing Programs staff will inform the prospective purchasers of the resale requirements affecting the unit to be purchased. Occupancy clearance will be approved by staff in writing to the Division of Land Use Controls only after this and all other affordability conditions have been met.
4. As a part of escrow proceedings on an affordable unit, the buyer must record a new covenant agreeing to comply with the requirements of the affordable housing program and a performance deed of trust secured by the property. Buyers of affordable units will not be allowed to move in until after close of escrow, except in exceptional circumstances and upon written approval of the Community Development Director.

X. CONTINUING AFFORDABILITY ASSURANCE

The City imposes affordability requirements for the long term, in most cases for ninety years or longer. To assure the continued affordability for this entire time, the City requires that a document be recorded which restricts the maximum rental or resale prices of the controlled units. Different forms of documents are used for rental projects and sale projects.

A. Affordability Assurance for Rental Projects

The City requires a covenant to be recorded against the project to assure continued affordability of controlled rental units. It implements the affordability controls and reporting requirements specified in the standard conditions. To assure compliance, it provides that in the event of any default under the covenant, the City will have the right to receive all rents due or collected from any unit rented in violation of the terms of the covenant. The City also has the right to enforce the covenant through legal action.

B. Affordability Assurance for Ownership Projects

The City requires that an affordability covenant be recorded against each controlled ownership unit to assure continued affordability. The covenant for ownership units is titled “Affordability Covenant and Option to Purchase.” This ownership covenant implements the affordability controls and reporting requirements specified in the Planning Commission's conditions on the project and in these Affordable Housing Policies and Procedures. The covenant is to be signed by the developer (seller), the new owner (buyer) and the City. Of course it is important for prospective developers, buyers and sellers to read and understand the current version of the covenant they will be required to sign. The following is a summary of some of the requirements of the covenant:

1. At the time of the buyer’s application to participate in the process of purchasing an affordable property, the buyer’s household income must not exceed the maximum for the specified income category (such as moderate income, middle income, etc.). Income from all adults who will occupy the property full-time shall be included in the household income. At all times during the term of the affordability covenant, an owner must occupy the property as his/her principal place of residence. The City retains the right to purchase affordable units when such units are in default or foreclosure. In addition, an owner assigns to the City the right to any rents collected in violation of the covenant.
2. Any sale or other transfer of any interest in the property must be approved by the City as being in compliance with the requirements set forth in the covenant, including the maximum sale price. Full disclosures must be made in writing to the City regarding the terms of the sale, including copies of all documents. The owner grants to the City an option, or right of first refusal, to purchase the property any time an owner wishes to sell.
3. The terms of all financing secured by the property requires pre-approval by the City, whether at the time of sale or at any other time and such approval shall be a condition

precedent to recording any deed of trust or other security instrument against the Property. The City will generally approve a refinancing of the first mortgage loan if no additional cash is taken out other than the loan costs, and the terms of the new loan are more favorable. If the owner wishes to take out cash, the City will consider the request on a case-by-case basis. If the City approves the borrower taking cash out for the purpose of paying off installment debt, the paydown of installment debt shall occur through the re-finance escrow. In cases where cash is to be taken out, generally the owner's total secured loans-to-value ratio should not exceed 80%, and the debt payment-to income ratio should not be higher than it was upon the owner's purchase of the property. If the City has secondary financing, refinancing will only be approved if the City's security interest and the owner's ability to repay remain strong. Please refer to the discussion of subordination of City financing in Section C below.

4. Owner(s) shall submit an annual report to certify full compliance with the terms of the covenant.
5. Purchasers of units with three or more bedrooms must be households of at least three persons. The Community Development Director or the Director's designee may approve exceptions to this household size requirement in cases where the buyer demonstrates a need for a large unit, or where necessary to prevent hardship.
6. The term of the covenant shall be at least ninety years from the date of the covenant. If an owner occupies the unit for the full term, the controls expire and the owner may sell the unit to any buyer for any price. However, if the owner sells the unit during the term of the covenant, the new owner will be required to sign and record a new covenant which begins a new ninety-year period of price and occupancy restrictions. This requirement will continue for each new owner of the unit.
7. An owner may not own other "residential real property" as defined by the City at the time of application to purchase or at any time during the period of the affordability covenant. The City considers the following to be "residential real property" for the purposes of this policy: long-term leaseholds, residentially-zoned land whether improved or unimproved, manufactured housing, and mobilehomes. The Community Development Director may waive this requirement for good cause. For example, the Director may waive the requirement when the ownership interest in another property is a small fractional interest, if the property has minimal value compared to the value of the affordable unit, or in the case of an existing affordable owner (in good standing) who has outgrown their unit due to birth or adoption. Years of ownership are not transferable. In the event an existing owner purchases another unit, they will be required to execute the current affordable covenant.
8. State redevelopment law requires, for affordable units receiving Agency subsidy, that the buyers' minimum housing expenses (including property taxes and HOA fees) be at least 28% of the buyers' income. This requirement helps to assure that the buyers who benefit from the Agency assistance are those who are in need of the assistance. The City will apply this requirement to all units.

9. The buyer's down payment must not be less than 5% or exceed 40% of the purchase price. The buyer's housing expenses, including taxes and HOA fees, shall not exceed 40% of the buyer's gross household income. The Community Development Director may waive these requirements for good cause. For example, the Director may waive the down payment limits where the buyer has cash for a larger down payment (perhaps from an inheritance or divorce settlement) but lacks the income to support a mortgage on an entry-level market rate unit.
10. A credit ("FICO") score within the bottom quartile of credit scores nationwide shall initially disqualify a buyer from owning an affordable unit. Upon disqualifying a buyer for this reason, City staff shall refer the disqualification to the Community Development Director for review and concurrence (or possible waiver). The credit score requirement may be waived by the Community Development Director on a case-by-case basis for good cause (such as mitigating circumstances for the low credit score).
11. Buyers may receive all or a portion of the down payment as a gift provided the gift does not exceed 20% of the purchase price and the donor provides a gift letter.

C. Subordination of City Financing

When the City provides low interest financing to assist affordable housing projects and the buyers of individual units, the City's financing is almost always secured by a deed of trust recorded subordinate to financing from other institutions. Often the owners wish to refinance the senior institutional financing to obtain a lower interest rate while keeping the City's loan in place. In such cases, the new lender requires the City to subordinate its deed of trust to the new financing, so the new financing retains priority in the event of default.

Generally the City will approve subordination requests when:

- the borrower is refinancing solely for the purpose of obtaining a lower interest rate, and
- the borrower is taking no cash out of the transaction, and
- the new institutional loan is fully amortized with no balloon payment, and
- the subordination does not place the City loan at greater risk.

Generally the City will *not* approve subordination requests when:

- the City financing is deferred or only partially amortized, and the borrower proposes to take cash out of the transaction, or
- the new institutional financing may result in negative amortization (unless the City is satisfied that there is adequate owner equity (at least 20 to 25%) and excellent credit history), or
- the subordination places the City loan at significantly greater risk, or
- the borrower is not in full compliance with the City's affordability requirements.

For subordination requests that do not fall neatly into either of the above two categories, the City will review the circumstances, and may approve or deny the subordination, or approve it subject

to conditions. For example, where the subordination places the City at a higher (but still acceptable) risk of loss, the City may require an extended period of affordability. As another example, in cases where the borrower is taking out a substantial amount of cash the City may require partial repayment of the City's loan from the cash to be taken out.

City Council and Redevelopment Agency Board have delegated authority to review subordinations on a case-by-case basis, for both affordable rental properties and owner occupied affordable units, and either approve, deny, or approve subject to conditions, provided:

- either the new senior loan amount is no more than the original amount of loan being replaced, or the total loans to property value does not exceed 80%, and
- the subordination does not place the City loan at significantly greater risk, and,
- the borrower is in full compliance with the City's affordability requirements

Such authority is delegated as follows:

1. For single-family or 1-4 unit owner-occupied properties, to the Community Development Director.
2. For multifamily rental properties, to the Loan Committee (comprised of the Finance Director, Assistant City Administrator and the Community Development Director).

XI. RESALE PRICE CALCULATION

Upon resale, affordable units must remain affordable to low or moderate income households in the community. Affordability is assured upon the sale of any affordable unit through the covenant, which sets forth the formula for calculating the maximum allowable price upon resale.

A. Standard Resale Price Formula

To set the price upon resale, Housing Programs staff starts with the price paid by the current owner and increases that price by the percentage increase in Area Median Income (AMI) during the period in which the Owner owned the Property.

B. Mid-Year Adjustment

Each of these indices is established annually. To allow for some projected increase in sales price between publication dates, the following increase shall be allowed:

one-half of the average annual percentage increase in the index over the previous two years, divided by twelve and multiplied by the number of months between the last publication of the index and the date of sale of the unit.

For example, if an affordable unit was sold in November, and the AMI was last published the preceding February, and the AMI increases for the previous two years were three percent and five percent, the mid-year adjustment would be calculated as follows:

$$\frac{1}{2} \times ((3\% + 5\%)/2) \times 1/12 \times 9 \text{ months} = 1.5\%$$

If the seller had bought the affordable unit for \$200,000, the mid year adjustment would amount to an additional \$3,000 to be added to the maximum sale price.

Note that this adjustment allows only one-half of the average recent increase. This is to prevent the adjustment from over-estimating the rate of increase in the index. In past years the growth of the index has sometimes suddenly slowed down, and using one-half of the average is a conservative approach to anticipate such slowdowns.

If this mid-year adjustment is added to the sale price of a unit, on the next resale of that unit, the price increase will be reduced by the amount of the mid-year adjustment which had previously been added, so that the price is not increased by both the real and projected increase during any period.

For example, in the above scenario a mid-year adjustment of \$3,000 was added to the sale price in November. This reflected an estimate of the increase in the AMI from February until November. Let's assume that the buyer paid \$220,000 for the unit in November, and then decided to sell the following March, right after a new AMI was published. The new AMI was 5% higher than that of the prior year. It makes sense to use this actual 5% increase in calculating the resale price. However, the amount of the mid-year adjustment that was given to the previous seller must be subtracted before the actual 5% increase is added. This is so the price is not increased by both the estimated increase in the AMI (the mid-year adjustment given to the previous seller) and the actual increase.

Thus, the resale price would be calculated as follows:

$$(\$220,000 - \$3,000) \times 105\% = \$227,850$$

C. Owner's Improvements

To help assure continued affordability to subsequent purchasers, no price increase or other reimbursement will generally be allowed for property improvements made by the owner. The owner is of course free to make improvements for the owner's benefit and enjoyment, but will not be compensated for such improvements upon sale of the property. The Community Development Director may approve, on a case-by-case basis, exceptions to the policy against price increases for property improvements, provided all of the following conditions are met:

1. The improvements were permanent and substantial.
2. The improvements were not of a decorative or maintenance nature, such as painting, wall coverings, window coverings, or replacement of carpeting. Landscaping plantings and hardscape may be eligible for a price increase, but only to complete a large area (such as a rear yard) that the developer left unimproved.
3. The improvements were not of a luxury nature, such as a spa, whirlpool tub, or brick bar-b-que. A deck or patio may be eligible, but only to the extent needed to provide a reasonable amount of usable outdoor living space. A fireplace addition may be eligible.
4. The allowed price increase for all improvements may not exceed the lower of:

- i. The actual out-of-pocket cost of eligible improvements paid by owner for design,
 - ii. The actual present value of the improvements as determined by City Housing Programs staff. This is the amount that the improvements would add to the market value of the unit at time of sale (ignoring the affordability restrictions). It should be noted that the value added by home improvements is usually less than the cost of the improvements. For example, a survey by Remodeling Online showed that the average homeowner in Los Angeles would recoup only about 70% of the cost of a bathroom remodel upon sale of the house; or,
 - iii. Ten percent (10%) of the otherwise maximum affordable sale price of the unit.
- 5. The combined actual present value of the eligible improvements as described above is at least one percent (1%) of the affordable sale price of the unit; and
- 6. The improvements were done with all required City permits and in compliance with any requirements imposed by the homeowners' association and CC&R's.
- 7. Owners who are planning to make improvements and hope to eventually add the value of the improvements to their sale price are required to obtain pre-approval from the City's Housing Programs office.

D. Other Requirements and Conditions

No percentage increase shall be allowed during such time, if any, that the owner was in violation of the requirements of the covenant. If the property is damaged or if there is substantial deferred maintenance, Housing Programs staff may lower the maximum sale price by the amount needed to repair the damage or to carry out the needed maintenance. The owner may not require the buyer to pay any commissions or other costs of sale typically paid by sellers of residential real property.

The City has the right to inspect an owner's property with reasonable notice to owner.

To assure compliance, the covenant provides that, in the event of default, the City shall have the option to purchase the property at the price determined under the formula, less six percent (6%) to cover the City's resale costs, and less damage repairs. The City may also enforce the covenant through the courts.

Note that the maximum sale price is not a guarantee that the owner will be able to sell for that price. In past years (under very different economic circumstances than today's) some buyers of affordable units have negotiated a price below the maximum price. The lower purchase price then became the basis for the calculation of the maximum sale price upon the next sale of the unit.

XII. CONCLUSION

This summary of the policies and procedures of the City's affordable housing program shows the strength of the City's commitment to encouraging and preserving housing which is affordable to households of all incomes in Santa Barbara.

If you have any questions about the topics covered in this manual, please contact Housing

Programs staff at 805-564-5461